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IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1933.

No. 128.

THE TEXAS AND PACIFIC RAILWAY COMPANY, *Appellant*,

versus

S. O. POTTORFF, Receiver of The First National Bank of El Paso, Texas, *Appellee*.

SUPPLEMENTAL REPLY BRIEF ON BEHALF OF S. O. POTTORFF, RECEIVER OF THE FIRST NATIONAL BANK OF EL PASO, TEXAS.

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We have shown that a pledge to protect a private depositor is illegal since it violates the policy of the law giving equal protection to all depositors. But, unless the enforcement of the pledge in this case is denied, that policy will be rendered nugatory. In other words, the present case is an example of those where a transaction fails because of public policy, and where that same public policy requires affirmative relief.

"Although the parties are in *pari delicto*, yet the court may interfere and grant relief at the suit of one of them,

where public policy requires its intervention, even though the result may be that a benefit will be derived by a plaintiff who is in equal guilt with defendant. But here the guilt of the parties is not considered as equal to the higher right of the public, and the guilty party to whom the relief is granted is simply the instrument by which the public is served." 13 Corpus Juris 497, Sec. 441.

The converse case of a bank being permitted to enforce an illegal agreement, because the public policy declaring the illegality requires the agreement to be enforced, is thus discussed by Professor Williston:

> "In some cases, where a refusal to enforce an agreement would produce the very effect which the law seeks to guard against, a corporation is allowed to enforce it, although it was particularly prohibited and made illegal. Thus, for the security of depositors and others, banks are prohibited from entering into certain kinds of loans or purchases. When a contract of this sort has been entered into, however, should the corporation be refused a right of recovery, the result would be the impairment of the assets of the bank—the very result which the law seeks to prevent, and, therefore, the bank is allowed to recover."

Williston on Contracts, sec. 1632, p. 2870, and cases cited. A defendant is not permitted to plead the illegal contract of a bank, where the enforcement of the contract is for the benefit of the bank. Thus, in Union Gold Mining Co. v. Nat'l Bank, 96 U. S. 640 (1877), Hunt, J., said that a defendant could not assert the *ultra vires* since "this would be to injure the interests of creditors, stockholders and all who have an interest in the safety and prosperity of the bank." So in Union Nat'l Bank of St. Louis v. Matthews, 98 U. S. 621 (1878), Swayne, J., said: "We cannot believe it was meant that stockholders, and perhaps depositors and other creditors, should be punished and the borrower rewarded, by giving success to this defence whenever the offensive fact shall occur."

The pledge in question was void and the bank itself could have rescinded the contract at any time. Not only *could* the bank have done this, but it *should* have done so. In Thomas v. West Jersey Railroad Co., 101 U. S. 71 on page 86, Miller, J., says:

> "Not only so, but it is a contract forbidden by public policy and beyond the power of the defendants to make. Having entered into the agreement, it was the duty of the Company to rescind or abandon it at the earliest moment. This duty was independent of the clause in the contract which gave them the right to do it. Though they delayed its performance for several years, it was, nevertheless, a rightful act when it was done. Can this performance of a legal duty, a duty both to stockholders of the Company and to the public, give to plaintiffs a right of action? Can they found such a right on an agreement void for want of corporate authority and forbidden by the policy of the law? To hold that they can, is, in our opinion, to hold that any act performed in executing a void contract makes all its parts valid, and that the more that is done under a contract forbidden by law, the stronger is the claim to its enforcement by the courts."

This would seem to end the matter. If the bank itself could and should have rescinded the pledge, then the receiver is justified in doing so on behalf of the bank and of the depositors.

Appellants urge that the pledge in question was executed on both sides and therefore the transaction is unassailable. The argument is unsound, since the pledge contemplated, not so much the deposit of securities, as the sale in case of default, and it is the sale which the railroad is now trying to compel. That the sale is the execution of the agreement is decided by the Supreme Court in First National Bank of Xenia v. Stewart, 107 U. S. 676, in which the court, speaking of an *ultra vires* pledge of bank stock by a borrower from a bank, says:

"While this section, in terms, prohibits a banking association from making a loan upon the security of shares of its own stock, it imposes no penalty, either upon the bank or borrower, if a loan upon such security be made. If, therefore, the prohibition can be urged against the validity of the transaction by anyone except the government, it can only be done before the contract is executed, while the security is still subsisting in the hands of the bank. It can then, if at all, be invoked to restrain or defeat the enforcement of the security. When the contract has been executed, the security sold, and the proceeds applied to the payment of the debt, the courts will not interfere with the matter."

Instead of the case at bar involving an executed transaction, it would seem that the transaction in question is entirely executory; and this court recognizes that such transactions are void and unenforceable.

Respectfully submitted,

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